

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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date: January 21, 2016

to: Thomas A. Friday
Senior Attorney
(Small Business/Self-Employed)

from: Adrienne E. Griffin
Senior Technician Reviewer
(Procedure & Administration)

subject: Abatement of Frivolous Return Penalty

This Chief Counsel Advice responds to your request for assistance of December 21, 2015. This advice may not be used or cited as precedent.

LEGEND

T

S

Y1

Y2

Y3

Y4

Y5

Y6

Y7

Y8

Y9

D1

D2

D3

ISSUE

You forwarded to our office the following question, which had been submitted by the Taxpayer Advocate Service (TAS):

“Does the IRS have the discretion to abate the IRC 6702 frivolous filer penalty due to the mental incompetency of the T?”

CONCLUSION

No. T, his representative or guardian may, however, wish to determine if T qualifies for a reduction of the frivolous return penalty pursuant to section 6702(d) and Rev. Proc. 2012-43, 2012-49 I.R.B. 643, discussed in more detail below.

FACTS

T receives social security disability and also a disability pension. He was a non-filer for the taxable years Y1, Y2, Y3, Y4, Y5, Y7, Y8 and Y9. The IRS created substitutes for return (SFRs), and after deficiency notices were issued, the income taxes were assessed. It also appears the Service levied on the taxpayer's social security and pension benefits to begin collecting the liabilities.

On D1, Y6 T submitted a Form 843 (claim for refund and request for abatement) asking for a refund of tax and assessed interest for taxable years Y3 and Y4. As best we can discern from the copy of the taxpayer's Form 843, he asked for a refund of the sums levied from his social security disability benefits. T's Form 843 contained the following statements: “I am a Private Government Entity & cannot be taxed. The money was illegally deducted from my disability payment. The IRS is in violation of the 5th and 14th Amendment of Due Process.” T also wrote the following across the top of the Form 843: “Request for net interest rate of zero under Rev. Proc. 2000-26.”

According to the Service's transcript, which you forwarded to our office along with correspondence from TAS, the Service assessed the \$5,000 frivolous return penalty under section 6702 based on T's Form 843. Prior to this assessment, the Service mailed to T a Letter 3176C, dated D2, Y7, allowing him to file a corrected Form 843 within 30 days. T did not reply to the Letter 3176C.

On D3, Y9 the United States District Court for the district of S issued an order which found that T was not competent to stand trial and ordered that he be released on bond, subject to restrictions (not relevant here).

LAW AND ANALYSIS

A taxpayer may be assessed the civil penalty under section 6702(a) if he: 1) files a document that purports to be an income tax return; 2) the purported return lacks the information needed to judge the substantial correctness of the self-assessment or contains information indicating the self-assessment is incorrect; and 3) the position on the document is frivolous or demonstrates a desire to delay or impede the administration of Federal tax law. *Callahan v. Commissioner*, 130 T.C. 44, 51 (2008). The Form 843, a document a taxpayer may use to seek a refund of tax, can be a purported return under section 6702. *Id.* (additional citations omitted). Pursuant to section 6702(c), the Service issued Notice 2007-30, 2007-14 I.R.B. 883, then issued updated Notice 2008-14, 2008-4 I.R.B. 310, and finally updated Notice 2010-33, 2010-17 I.R.B. 609, which identify positions the Service determined are frivolous. Notice 2008-14 was effective for submissions and issues raised after January 14, 2008.

The statements T placed on Form 843—that he is a private governmental entity, not subject to taxation and that the Service’s actions violate the 5th and 14th Amendments to the U.S. Constitution—are similar or substantially similar to the frivolous positions listed in Notice 2008-14 ¶¶ (7) and (9).

Section 6404 authorizes the Service to abate the unpaid portion of an internal revenue tax or liability which is excessive or illegally assessed.¹ Our office has located no reported case, regulation or written policy of the Service authorizing or requiring the abatement of the section 6702 frivolous return penalty when it is shown that the taxpayer is mentally incompetent. Moreover, because there is no indication that T filed the Form 843 in response to erroneous written advice from an employee of the Service, the abatement authority under section 6404(f) is inapplicable.

Next, we summarize the body of law developed under the Code’s civil fraud penalty, currently section 6663, in order to provide examples of situations in which an individual’s mental capacity impacts whether he can be held liable for a penalty. To sustain the civil fraud penalty, the Service must establish: 1) an underpayment of tax; and 2) that some part of the underpayment was due to fraud. *Knutsen-Rowell, Inc. et al. v. Commissioner*, T.C. Memo. 2011-65. A taxpayer’s entire course of conduct can

¹ Section 6404(a)(2) also authorizes an abatement of an assessment made after the applicable expiration of the period of limitations on assessments. No information was submitted to our office indicating the assessment of the frivolous return penalty against taxpayer was made outside the limitation period.

establish the requisite fraudulent intent. *May v. Commissioner*, 137 T.C. 147, 154 (2011).

Courts have refused to sustain the civil fraud penalty in cases when the taxpayer's mental condition established that his or her intent was not fraudulent. See, e.g. *Simonelli v. Commissioner*, T.C. Memo. 1985-12 (taxpayer, who was periodically admitted to mental hospitals, not shown to deliberately attempt to avoid taxes when he destroyed tax records); *Hollman v. Commissioner*, 38 T.C. 251 (1962) (no fraudulent failure to report capital gain by taxpayer who suffered from severe psychosis or mental disease). By contrast, when the requirements for imposition of the civil fraud penalty were established and the record showed that the taxpayer conducted business activities or managed his affairs, the courts have upheld the Service's assessment despite claims that mental incapacity negated fraudulent intent. *Parker v. Commissioner*, T.C. Memo. 1985-263 (taxpayer's mental illness only affected some areas of his life and he continued to work as tax return preparer during years at issue when he misappropriated employer's funds); *McCue v. Commissioner*, T.C. Memo. 1983-273 (notwithstanding testimony of psychiatrist indicating taxpayer was mentally ill in belief that tax law did not apply to him, evidence also showed taxpayer contacted congressmen and attorneys to resolve his tax situation). Unlike the civil fraud penalty, the elements of the frivolous return penalty under section 6702(a) do not include the taxpayer's intent in filing a frivolous tax return.² Consequently, the above-cited cases do not support abatement of the frivolous return penalty in this case.

We located at least one reported case in which a taxpayer contested her liability for additions to tax under section 6651(a)(1) for filing returns late because she was age 11-14 during the years the returns were due and did not have the legal capacity to file the returns. *Bassett v. Commissioner*, 67 F.3d 29 (2d Cir. 1995). *Bassett*, however, is of limited utility in addressing whether the Service is authorized to abate the section 6702 penalty. The Court of Appeals in *Bassett* sustained the Tax Court's opinion that because under New York law the parents of a child are the child's legal guardians, section 6012(b)(2) placed the responsibility to file the tax returns on the guardian. *Bassett*, 67 F.3d at 30-31. According to the appeals court the proper focus was therefore on whether the child's guardians showed reasonable cause for the late-filed returns. *Id.* at 32. The frivolous return penalty under section 6702, unlike the additions to tax under section 6651 or the accuracy-related and civil fraud penalties, includes no reasonable cause defense.³

² The third requirement for assessing the frivolous return penalty, noted above, includes an exception to this general rule. Specifically, under section 6702(a)(2) the Service must show that a taxpayer's conduct is based on a position the Service has identified as frivolous *or* reflects a desire to delay or impede the administration of Federal tax laws. The second part of this test, therefore, takes into account the taxpayer's intent in filing the particular document at issue. However, intent is not relevant in this case because T's conduct was based on a position the Service has identified as frivolous.

³ Even assuming that the Service is authorized to abate a penalty assessed under section 6702 if the taxpayer is incompetent, the information we presently have would not necessarily support abatement. In particular, the timing of the district court's finding of incompetency to stand trial would weigh against

T or his representative (if any) may wish to determine if he qualifies for a reduction of the frivolous return penalty under section 6702(d), which reads “The Secretary may reduce the amount of any penalty imposed under this section if the Secretary determines that such reduction would promote compliance with and administration of the Federal tax laws.” The Service implemented this subsection through publication of Rev. Proc. 2012-43, 2012-49 I.R.B. 643, which describes the limited circumstances under which a taxpayer assessed a penalty under section 6702(a) or (b) is eligible for a one-time reduction of any unpaid penalty liability. The revenue procedure applies to any person who has not fully paid the \$5,000 penalty and who seeks a reduction of such penalty pursuant to section 6702(d).⁴

A taxpayer can request this reduction of the frivolous return penalty under section 6702 by: 1) making a written request for reduction on Form 14402 (“IRC 6702(d) Frivolous Tax Submissions Penalty Reduction”) or a successor form, 2) remitting a payment of \$500.00 in either of the two ways stated in Rev. Proc. 2012-43, section 2.01(2), 3) making the request before the United States files suit against the person for collection of the penalty; and 4) being in full compliance with all Federal tax filing and payment requirements. T or his representative should review Rev. Proc. 2012-43, as it contains more specific information about these requirements and also includes disqualifying events, the time limitation for qualification and other information.⁵

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

None identified

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Please call (202) 317-6845 if you have any further questions.

abatement. The district court issued its order during October 2012, which was 4 years *after* the taxpayer submitted the Form 843 to the Service. Given this series of events, it is not certain the taxpayer was incompetent during May 2008 when he completed and mailed the Form 843 to the IRS.

⁴ If the taxpayer qualifies, the outstanding section 6702 penalty liability can be reduced to \$500.00. See Rev. Proc. 2012-43, sec. 4.01(1) and (2).

⁵ The taxpayer will have to be in full compliance with all Federal tax filing and payment requirements as one of the prerequisites to securing a reduction of the frivolous return penalty. Rev. Proc. 2012-43, sec. 4.03.